19

CERTIFICATE.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, ~~1912~~. 1913

No. ~~971~~. 457

STRATTON'S INDEPENDENCE, LIMITED,

vs.

F. W. HOWBERT, COLLECTOR OF INTERNAL REVENUE WITHIN AND FOR THE DISTRICT OF COLORADO.

ON A CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

FILED FEBRUARY 14, 1913.

(23,546)

(23,546)

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1912.

No. 971.

STRATTON'S INDEPENDENCE, LIMITED,

vs.

F. W. HOWBERT, COLLECTOR OF INTERNAL REVENUE WITHIN AND FOR THE DISTRICT OF COLORADO.

ON A CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

INDEX.

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., MAY 24, 1913.

1 United States Circuit Court of Appeals, Eighth Circuit, December Term, A. D. 1912.

No. 3862.

STRATTON'S INDEPENDENCE, LIMITED, Plaintiff in Error,
vs.
F. W. HOWBERT, Collector of Internal Revenue within and for the District of Colorado, Defendant in Error.

The United States Circuit Court of Appeals for the Eighth Circuit, sitting at St. Louis, Missouri, on the 31 day of January, A. D. 1913, certifies that the record in the case above entitled, which is pending in this court upon a writ of error to review the judgment in favor of the defendant in error, in an action brought by the plaintiff in error for the purpose of recovering taxes paid by the plaintiff in error under protest and collected by the defendant in error under the provisions of Section 38 of the Act of Congress entitled "An Act to provide revenue, equalize duties and encourage the industries of the United States and for other purposes," approved August 5, 1909. 36 Stat. 11.

The plaintiff in error in its complaint alleged that it was a foreign corporation, organized and existing under and by virtue of the laws of the Kingdom of Great Britain and Ireland, and qualified to do business in the State of Colorado; that it is the owner of certain mining premises situate, lying and being in the County of Teller, in the said State of Colorado, and of certain buildings, machinery and improvements thereon; that it was at all of the
2 times mentioned engaged in carrying on mining and milling operations in and upon the above mentioned premises; that said operations consist, and have at all times mentioned herein, consisted of the digging and driving of shafts, tunnels and other mine workings in and through the above mentioned premises for the purpose of discovering and mining and of extracting large bodies of mineral bearing rock containing valuable contents of gold and other valuable metals from and out of said premises, and hoisting the same to the surface, and marketing a part thereof directly and in milling the greater part thereof; that in and about the mining and milling of said ores it employs all of the improvements on said premises; that in the milling of said ores the same are crushed and concentrated and subjected to the cyanide process on the premises by means of machinery and improvements belonging to the plaintiff, and being on and a part of said premises; that all of said property is real property; that it is not now, and has not at any time herein mentioned, had any property in the United States of America other than that above mentioned, and all proceeds it has received from the mining and milling of the ores extracted from said premises and from no other source whatsoever; nor has it during all the time

above mentioned engaged in any other enterprise than that described.

That during the year 1909 it extracted from said premises valuable ores which had at all times prior to said extraction been a part of said realty, and sold the same, realizing therefrom the sum of Two Hundred Eighty-four Thousand, six hundred eighty-two dollars and eighty-five cents ($284,682.85); that it filed its report with the defendant, the Internal Revenue Collector for
3
the District of Colorado, in which said report were set out fully the results of said operations, sales, and expenditures hereinbefore alleged; that among the items of expenditures claimed to have been made by the plaintiff in error, and which the defendant as Collector refused to deduct as part of the expenses of operation of said property, or as depreciation, was an item of Twenty-three thousand, three hundred ninety-four dollars and twenty cents ($23,394.20) for depreciation of the ore taken out of the mine, and which was not charged off on the books of the plaintiff in error on that particular account.

There were also other items of expense which were disallowed and deducted by the Collector, all of which amounted to the sum of Eighty-six thousand, nine hundred twenty-four dollars and ninety-three cents ($86,924.93), but which it is unnecessary to state in this certificate. That the defendant as Collector assessed plaintiff in error with a tax of one per cent on this amount, and being threatened with the penalty of five per cent and interest at one per cent per month and that its property would be distrained by the Collector if said tax was not paid, it paid the same under protest and notice that suit would be instituted to recover the amount and that by the Commissioner of Internal Revenue; that a claim for abatement of said taxes was made to the Commissioner of Internal Revenue on the form provided by the Commissioner for that purpose and was refused by the Commissioner on April 15, 1911.

That the item of Twenty-three thousand three hundred
4
ninety-four dollars and twenty cents ($23,394.20) charged as depreciation and disallowed by the defendant in error then and there represented the difference between the proceeds realized from the said sale of ores during the said year 1909 and the total outlay of the plaintiff for said period, and therefore it is claimed by plaintiff in error was not subject to said annual corporation tax, as it represents in fact a depreciation of the said premises and in no sense a profit of operations.

There is also a second count to recover from the Collector for a payment of the tax made under the same conditions for the year 1910.

The answer of the Collector is a general denial.

The cause was tried to a jury and submitted on an agreed statement of facts. The jurisdictional averments in the complaint and the payment under protest, the appeal to the Commissioner of Internal Revenue and the threat to distrain were all admitted and the following facts agreed on which relate to the questions now certified:

"4. That as to the allegations contained in paragraph 'fourth'

in said first cause of action, the facts are as follows: In the year 1909 the plaintiff extracted from its said mining premises certain ores bearing gold and other precious metals, which were sold for the sum of Two hundred and eighty four thousand, six hundred eighty two dollars and eighty five cents ($284,682.85) gross; that for the purpose of extracting, mining and marketing the same it expended the sum of One hundred and ninety thousand, nine hundred thirty nine dollars and forty two cents ($190,939.42); that the value of said ores so extracted in the year 1909 when in place in said mine and before said extraction thereof, was Ninety three thousand, seven hundred forty three dollars and forty three cents ($93,743.43)."

After stating the other expenses, amounting to Sixty-two thousand, two hundred twenty two dollars and seventeen cents ($62,222.17), the agreed statement proceeds:

"That the plaintiff reported said receipts and expenditures to the defendant, the Collector of Internal Revenue, and that the plaintiff was assessed a tax of one per cent on the sum of Eighty one thousand, nine hundred twenty four dollars and ninety three cents ($81,924.93), making a total tax of Eight hundred nineteen dollars and twenty nine cents ($819.29), that the plaintiff was thereupon notified that such tax was due and payable and that unless said tax was paid on or before March 16, A. D. 1911, the defendant intended to proceed to collect the same, with a penalty of five per cent additional and interest at one per cent per month, that plaintiff thereupon made a claim for abatement of taxes, addressed to the Commissioner of Internal Revenue on form No. 47 provided by said Commissioner for that purpose, that said claim for payment was submitted to said Commissioner of Internal Revenue, and thereafter, and upon the 14th day of April, A. D. 1911, the said Commissioner of Internal Revenue ruled upon said claim for abatement and refused to allow the same, that thereafter, and on, to wit, the 16th day of April, A. D. 1911, the plaintiff was notified by the defendant that he, the said defendant, had been instructed to collect the said tax in the regular way, and the defendant advised the plaintiff that unless said tax was paid distraint therefor would be made upon the property of the plaintiff; that the plaintiff did then and there pay to the defendant the sum of eight hundred and nineteen dollars and twenty four cents ($819.24) which said sum was received by the defendant, and that there was endorsed upon the voucher or receipt for the same the plaintiff's protest against making said payment.

"5. That as to the allegations contained in paragraph numbered Fifth" in said first cause of action the facts are that all of said sum of Two hundred eighty four thousand, six hundred eighty-two dollars and eighty five cents ($284,682.85) received by the plaintiff during the year 1909 was received from the sale of ores mined and extracted from the premises as alleged in the complaint, and that the plaintiff paid the said Eight hundred and nineteen dollars and twenty four cents ($819.24) in order to avoid distraint of its property."

The agreed statement then proceeds as to other items in the complaint, but which are not certified hereby. The agreed statement as to the second cause of action is practically the same as that relating to the first count, except as to dates and amounts.

After the reading of this agreed statement of facts the following stipulation was presented for the consideration of the court as to the questions of law:

"1. Is the value of the ore in place that was extracted from the mining property of the plaintiff during the years in question properly allowable as depreciation in estimating the net income of the plaintiff subject to taxation under the Act of Congress of August 5th, 1909, 36 Stat. c. 6, p. 11?

"2. Is the right to such credit affected by the fact that the plaintiff does not carry such items on its books as a depreciation account?

"3. Is the said act constitutional as applied to foreign corporations such as the plaintiff?"

Both parties having moved the court for a directed verdict upon the agreed statement of facts, the jury, by direction of the court, returned a verdict for the plaintiff for the amounts which were undisputed, but the court refused to direct a verdict for the amount of the taxes paid on the claimed value of the ore in the mine, and which was claimed as a depreciation, but directed the jury to find for the defendant in that sum, which the jury accordingly did. To this ruling of the court proper exceptions were taken by the plaintiff in error.

And the Circuit Court of Appeals for the Eighth Circuit further certifies that the following questions of law are presented to it in the case above entitled, that the decision of each of these questions is indispensable to a determination of this cause, and that the case may be properly determined and disposed of without the instruction of the Supreme Court of the United States upon these questions:

"1. Does section 38 of the Act of Congress entitled 'An Act to provide revenue, equalize duties and encourage the industries of the United States, and for other purposes,' approved August 5th, 1909, 36 Stat. p. 11, apply to mining corporations?

"2. Are the proceeds of ore mined by a corporation from its own premises thereby within the meaning of the aforementioned Act of Congress?

"3. If the proceeds from ore also are to be treated as income of such a corporation entitled to deduct the value of such ore in place and before it is mined as depreciation within the meaning of Section 38 of said Act of Congress?"

WALTER H. SANBORN,
Circuit Judge.
JACOB TRIEBER,
District Judge.
WM. H. MUNGER,
District Judge.

Filed Jan. 31, 1913.
JOHN D. JORDAN, *Clerk.*

9 United States Circuit Court of Appeals, Eighth Circuit.

I, John D. Jordan, Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, do hereby certify that the foregoing certificate in the case of Stratton's Independence, Limited, Plaintiff in Error, vs. F. W. Howbert, Collector of Internal Revenue within and for the District of Colorado, No. 3862, was duly filed and entered of record in my office by order of said Court, and as directed by said Court, the said certificate is by me transmitted to the Supreme Court of the United States for its action thereon.

In Testimony Whereof, I hereunto subscribe my name and affix the seal of the United States Circuit Court of Appeals for the Eighth Circuit, at the City of St. Louis, Missouri, this thirty-first day of January, A. D. 1913.

[Seal United States Circuit Court of Appeals, Eighth Circuit.]

JOHN D. JORDAN,
Clerk of the United States Circuit Court of Appeals for the Eighth Circuit.

10 [Endorsed:] U. S. Circuit Court of Appeals, Eighth Circuit. December Term, 1912. No. 3862. Stratton's Independence, Ltd., Plaintiff in Error, vs. F. W. Howbert, Collector of Internal Revenue, etc. Certificate of Questions to the Supreme Court of the United States. Filed Jan. 31, 1913. John D. Jordan, Clerk.

Endorsed on cover: File No. 23,546. U. S. circuit court of appeals, 8th circuit. Term No. 971. Stratton's Independence, Limited, vs. F. W. Howbert, collector of internal revenue within and for the district of Colorado. Filed February 11, 1913. File No. 23,546.

20.

No. ~~871~~. 457

In the Supreme Court of the United States.

OCTOBER TERM, 1912.

STRATTON'S INDEPENDENCE, LIMITED,

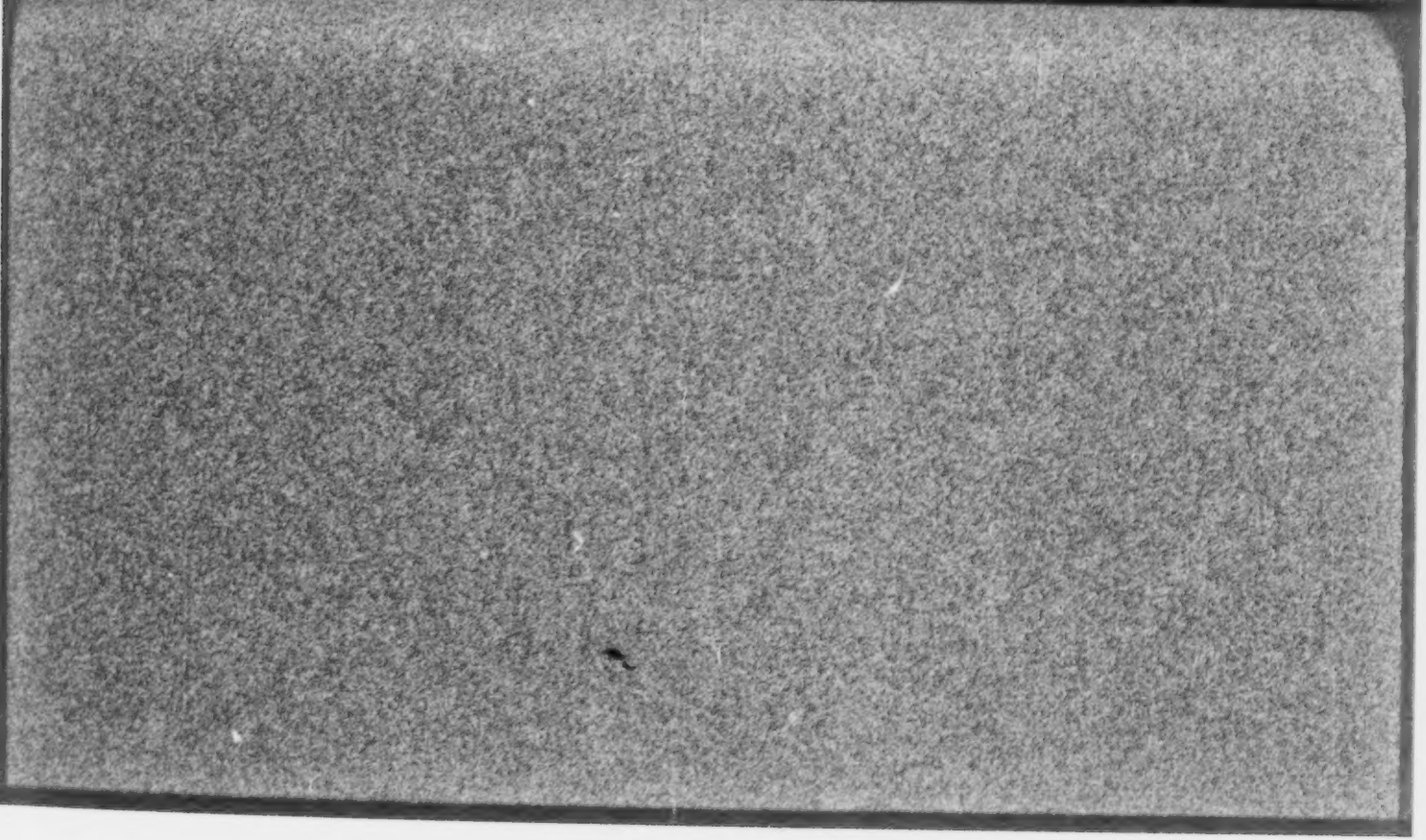
v.

F. W. HOWBERT, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF COLORADO.

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

MOTION TO ADVANCE.

WASHINGTON: GOVERNMENT PRINTING OFFICE: 1913



In the Supreme Court of the United States.

OCTOBER TERM, 1912.

STRATTON'S INDEPENDENCE, LIMITED, v. F. W. HOWBERT, COLLECTOR OF INTERNAL REVENUE for the District of Colorado.	No. 971.

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

MOTION TO ADVANCE.

The Attorney General, on behalf of the United States, moves the court to advance the above cause for hearing during the next term.

This cause involves the following questions, as certified by the Circuit Court of Appeals for the Eighth Circuit:

> 1. Does Section 38 of the Act of Congress entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August 5th, 1909 (36 Stat., p. 11), apply to mining corporations?
>
> 2. Are the proceeds of ores mined by a corporation from its own premises income within the meaning of the aforementioned Act of Congress?

3. If the proceeds from ore sales are to be treated as income, is such corporation entitled to deduct the value of such ore in place and before it is mined as depreciation within the meaning of Section 38 of said Act of Congress?

The questions so presented have been answered in one way by the District Court of the United States for the Southern District of New York in the case of the *United States* v. *The Nipissing Mines Company* and in another way by the District Court of the United States for the District of Colorado in the case at bar.

The determination of these questions is of great importance to the Internal Revenue Department in the administration of the Corporation Tax Law in so far as it affects mining corporations. There are from 2,500 to 4,000 suits and claims pending involving this question, and the total amount involved is estimated as from eight to ten million dollars. Many of these claims have not yet been put in suit, but as the statute of limitations expires within a limited time, unless an early decision by the highest court is obtained, it will be necessary for these claimants to bring suit upon their claims in order to save the running of the statute. It is apparent, therefore, that an early disposition of this case is of importance both to the Government and to persons engaged in mining operations.

Opposing counsel concur.

JAMES C. McREYNOLDS,
Attorney General.

WILLIAM R. HARR,
Assistant Attorney General.

APRIL 7, 1913.

INDEX

CASES CITED

In the Supreme Court of the United States.

October Term, 1913.

No. 457.

STRATTON'S INDEPENDENCE, LIMITED,

vs.

F. W. HOWBERT, Collector of Internal Revenue within and for the District of Colorado.

On a Certificate from the United States Circuit Court of Appeals for the Eighth Circuit.

STATEMENT.

Stratton's Independence, Limited, is a corporation organized under the laws of the Kingdom of Great Britain and Ireland, carrying on mining operations in the State of Colorado, and is the plaintiff in error in Cause No. 3862 in the United States Circuit Court of Appeals, Eighth Circuit, from which court the questions herein are certified.

During all the time in question in said action this company has owned certain mining premises purchased by it for three hundred and thirty-five thousand dollars ($335,000) in cash, on July 29, 1909, and its sole activities have been the mining and marketing

of the ores therefrom. During the years 1909 and 1910 it mined ores therefrom and sold the metal contents for a price in excess of the cost of mining, extracting, and marketing the same. By stipulation in the case it is agreed that such excess represents the true value of the ores so extracted, when in place. The collector of internal revenue for the District of Colorado assessed, levied, and collected from the company a tax of one per cent (1%) upon such excess, without deduction, other than the arbitrary deduction of five thousand dollars ($5,000) per annum, claiming that such excess represented the net income of the company, and that a tax was properly collectible thereon, under the provisions of section 38 of the act of Congress entitled "An act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August 5, 1909 (36 Stat. at Large, p. 11). (We print the parts of the section material to this question as Appendix I of this brief.)

The company laid proper foundation for the recovery of the tax, by the necessary appeals to the Commissioner of Internal Revenue, and by payment under protest.

Three questions are certified to this court, as follows:

> "I. Does Section 38 of the Act of Congress entitled 'An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes,' approved August 5, 1909 (36 Stat., p. 11), apply to mining corporations?

II. Are the proceeds of ores mined by a corporation from its own premises income within the meaning of the aforementioned Act of Congress?

III. If the proceeds from ore sales are to be treated as income, is such a corporation entitled to deduct the value of such ore in place and before it is mined as depreciation within the meaning of Section 38 of said Act of Congress?"

ARGUMENT.

We consider the questions in the order in which they are numbered in the certificate:

"I. DOES SECTION 38 OF THE ACT OF CONGRESS ENTITLED 'AN ACT TO PROVIDE REVENUE, EQUALIZE DUTIES, AND ENCOURAGE THE INDUSTRIES OF THE UNITED STATES, AND FOR OTHER PURPOSES,' APPROVED AUGUST 5, 1909 (36 STAT., P. 11), APPLY TO MINING CORPORATIONS?"

The company contends for a negative answer to Question One.

A consideration of section 38, in the light of the constitutional limitations surrounding its enactment, as defined in the *Pollock* case, the provisions therein for the determination of "income" and "depreciation" and for the measurement of the tax, its objects and intended operation, demonstrates that it was framed to include transportation, manufacturing, financial,

trading, and insurance corporations, etc., engaged in the use of capital, in business activities, for the purpose of *adding* to the capital employed, by the use of such capital, and *by means of such activities*, and that it was not framed to include mining corporations which are engaged solely *in the conversion of capital into cash*, and the distribution thereof among their shareholders.

In support of this contention, we present the following propositions:

FIRST

Mining corporations are not included in general classifications of corporations, as such classifications are used in legislation. The fact that the natural enjoyment of a mining estate results in the waste of the estate, and the fact that the true value thereof is impossible of determination, have caused such properties to be considered as anomalous, and to be so treated in the general incorporation laws of the mining states, and the decisions of the courts relating thereto, in the laws establishing systems of taxation in the mining states, and by the decisions under the Federal Bankruptcy Act of 1898.

SECOND

In the administration of section 38, the Commissioner of Internal Revenue at first recognized that the provisions thereof do not fit the conditions of a mining corporation, and attempted to make over the act of Congress by administrative legislation. (T. D. 1742, December 15, 1911; printed as Appendix II to this brief.)

THIRD

Mining corporations are not engaged in carrying on business within the meaning of the act.

FOURTH

The application of the act to mining corporations results in a tax upon the capital itself, while, as applied to corporations having an income, as distinguished from capital, it does not result in a tax upon capital. This inequality of operation is inherently unjust. Laying aside all questions of constitutional limitations, the act should not be so construed as to accomplish this unjust result, if there be a fair and reasonable construction to be given the act which will avoid such an unjust result.

FIFTH

The proceeds of mining operations do not represent values created by, or incident to, the business activities of such a corporation, and cannot be a *bona fide* measure of a tax leveled at such corporate business activities.

SIXTH

The measurement of the tax by the excess of the receipts for ore marketed over the cost of mining, extracting, and marketing the same is equivalent to a tax upon the usual and ordinary incidents of ownership of such property—such a direct tax as is prohibited by the Constitution—and, further, is such a tax as Congress, by the provisions for the deduction of depreciation provided in the act, expressly intended to avoid.

SEVENTH

The proceeds of mining operations result from a conversion of the capital represented by real estate into capital represented by cash, and are in no true sense "income." The act cannot apply to a corporation which has no "income."

EIGHTH

The act ought not to be construed to include mining corporations unless it clearly appears that Congress intended to include them. It is an established canon of construction in this court that "duties are never imposed on the citizen upon vague or doubtful interpretations."

NINTH

The fact that mining corporations come within the letter of the act, if true, does not conclude the argument; for, if mining corporations be not within the spirit of the act, it is not applicable to them.

FIRST

Mining Corporations Are Not Included in General Classifications of Corporations, as Such Classifications Are Used in Legislation. The Fact that the Natural Enjoyment of a Mining Estate Results in the Waste of the Estate, and the Fact that the True Value Thereof is Impossible of Determination, Have Caused Such Properties to Be Considered as Anomalous, and to Be so Treated in the General Incorporation Laws of the Mining

States, and the Decisions of the Courts Relating Thereto, in the Laws Establishing Systems of Taxation in the Mining States, and by the Decisions under the Federal Bankruptcy Act of 1898.

Mining corporations engaged solely in mining their own premises have but one kind of assets, and those assets consist of the mining premises, and the improvements and equipment used in and about the mining of the same. The ordinary use of such premises consists of the extraction of the valuable materials therefrom, and the sale or other disposition of them. The enjoyment of the assets and the wasting thereof are in direct proportion. The value of such mining premises is impossible of determination. The known value—that is to say, the value of that part of such premises as may have been developed and disclosed to view—may often be computed with reasonable accuracy; but rarely, if ever, does that known value represent the true value of the premises, for the true value depends upon what may be found in parts of the property which have not been disclosed to view and cannot be intelligently and accurately computed. From these physical facts it follows that mining premises cannot be assessed and taxed by the same methods that successfully apply to other classes of property. It likewise follows that general laws for the formation and conduct of corporations—particularly those which deal with capital, the distribution thereof, and subscriptions to stock therein—customarily fail to meet the exigencies of mining corporations. The fact that mining enterprises are *sui generis* is generally recognized.

Special provision for the taxation of mining claims has been made in the following instances:

Colorado Revised Statutes, 1908, sections 5617-5627; as amended, Laws 1913, pps. 565-567.

Montana Revised Political Code, 1907, sections 2500, 2563-2571.

Nevada Revised Laws, 1912, sections 3687-3709.

Idaho Revised Codes, sections 1863-1872.

Utah Compiled Laws, 1907, sections 2504, 2566-2573.

Washington Laws, 1897, page 155.

New Mexico Compiled Laws, 1897, sections 1560, 1756.

Wyoming Compiled Statutes, 1910, sections 2149-2154.

Oklahoma Laws, 1907-1908, Chapter 71, Article 2; Laws 1909, Chapter 38, Article 2. Compiled Laws, sections 7702, 7703, 7706.

The courts recognize the same necessity for special treatment of this class of properties.

Thus, in Taxation of Mining Claims, 9 Colo., 635, 639, the Supreme Court of Colorado said:

> "While holding that there is no other constitutional basis for the taxation of property than that of valuation, we fully appreciate the difficulty of devising any plan which will enable an assessor to ascertain the

quantity of precious metals which lie hidden in the treasure vaults of our mines, and to correctly estimate their values. At best, the true values of mining claims can only be approximated. In connection with this subject the legislature must encounter peculiar difficulties, from the nature of the property." See also:

Pilgrim Consolidated Mining Co. vs. Teller County, 32 Colo., 334.

People ex rel. Iron Silver Mining Co. vs. Henderson, 12 Colo., 369.

This has led to a recognition of the fact that mines, by their very nature, must be taxed by special law.

Foster vs. Hart Consolidated Mining Co., 52 Colo., 459.

In a number of mining states the statutes make express exceptions, applicable to mining corporations, in relation to the conveyance of mining properties in exchange for capital stock, regardless of the true value thereof, and for disposition of the same on liquidation.

See:

Colorado Revised Statutes, 1908, sections 975-983.

Montana Revised Civil Code, 1907, sections 3824, 3860, 3896, 4403-4412.

North Dakota Revised Code, 1899, sections 3154-3161.

Nevada Revised Laws, 1912, sections 1200-1202, 1216-1218, 1330-1340.

Kerr's California Civil Code, sections 586-590.

Lord's Oregon Laws, sections 6713-6715.

Washington, Ballinger's Annotated Code, 1897, sections 4280-4284.

Under statutes of this type decisions have been made which demonstrate the necessity of special treatment of mining premises when constituting the capital back of corporate shares.

In A. Leschen & Sons Rope Co. vs. Allen, 187 Fed., 977, at 980, Judge Grosscup said:

> "Mining enterprises are essentially different from business enterprises generally. In a mining enterprise, initially, the visible asset usually is a little tract of ground staked out, and worth nothing except for what may be found underneath. What may be found underneath is a prospect only; so that the mining enterprise that begins with such a tract of ground is, to a large degree, a legalized gamble—legal and laudable because it is the only way in which useful minerals can be brought to the uses of civilization. As the enterprise is different from enterprises generally, so its financing must be different."

In In re South Mountain Consolidated Mining Co., 14 Fed., 347, at 349, Judge Sawyer said:

> "They (mining corporations) are organized and carried on upon principles, in these

> respects, wholly different from banking, railroad, insurance, and like commercial corporations having a subscribed capital stock. * * * Recent decisions of the Courts in the eastern states in relation to commercial corporations having a subscribed stock, organized and carried on upon different principles, have suggested to creditors the application of the remedy to mining corporations. So far as my knowledge extends, this is the first instance in this state of any attempt to enforce a remedy which could not have been contemplated by the creditors of this or any other mining corporation when the indebtedness was contracted."

To the same effect, see Ross vs. Silver & Copper Island Mining Co., 36 Minn., 38; 29 N. W., 591; s. c., 31 N. W., 219.

No other conclusion than that arrived at in the cases just cited could well be reached in view of the conceded fact that the uncertain value of mining premises renders it impossible to capitalize them at a fixed value; and all persons dealing with mining corporations must know and understand that the nominal capitalization does not, and cannot, represent the true value of the capital of the corporation—that the true value may be very much less, or very much in excess of, the par value of the outstanding stock.

Under the Bankruptcy Act of 1898 it was repeatedly held that a mining corporation is not engaged in "manufacturing, trading, printing, publishing or

mercantile pursuits. As the court said in In re Elk Park Mining & Milling Co., 101 Fed., 122-123:

> "I do not think a mining corporation can be regarded as a trading corporation, or that it is in mercantile pursuits. * * * Certainly, a mining corporation, which is organized for operating a mine and getting precious metals from it, cannot be said to be engaged in any species of trading. * * * I am inclined to think that counsel is correct in his position that a mining corporation is not a trading or manufacturing corporation, or one engaged in mercantile pursuits."

Accord:

> In re Rollins Gold & Silver Mining Co., 102 Fed., 982.
>
> In re Keystone Coal Co., 109 Fed., 872.
>
> In re Woodside Coal Co., 105 Fed., 56.

In the last mentioned case (at page 57) the court made the comment that

> "It may, perhaps, be worth suggesting that although mining companies are in some sense engaged in trade, nevertheless they belong so plainly to a distinct class of trading corporations that they are almost always specifically named in any statute that is intended to embrace them. Failure to name them, therefore, raises a presumption of some force that they were not in the legislative view."

The foregoing instances of the special treatment of mines and mining corporations show that a general classification of corporations in the legislative mind ordinarily excludes mining corporations. And this condition is especially pronounced in legislation relating to taxation.

SECOND.

In the Administration of Section 38, the Commissioner of Internal Revenue at First Recognized that the Provisions Thereof Do Not Fit the Conditions of a Mining Co-poration, and Attempted to Make over the Act of Congress by Administrative Legislation. (T. D. 1742, December 15, 1911; Printed as Appendix II to This Brief.)

We call attention to Treasury Decision 1742 for the purpose of showing the contemporaneous construction of Section 38 by those officers of the government having its administration in charge. It is obvious that the fabric of the act needs some very considerable stretching to bring within its operation a corporation which has no "income", and which is exhausted in the process of "enjoyment." The Commissioner's attempt to fit the law to the occasion shows a recognition of these incongruities, and an attempt to extend the act by administrative action beyond the legislative intent.

In the District of Colorado, and possibly elsewhere, no attempt is now made to apply Treasury Decision 1742. So far as we are advised, the government now denies all allowances for depreciation on

account of net value of ores extracted, and includes the proceeds of all such ores within its classification of gross income.

That a mining property does not in fact cease to depreciate until all values therein have been exhausted was fully realized by the Commissioner. If one applies the language of Section 38, "including a reasonable allowance for depreciation of property," to a mining corporation, the "net income" is nothing. Therefore, the Commissioner undertook to fit the law to the occasion by promulgating Treasury Decision No. 1742, sections 97 to 105, inclusive.

The Commissioner, by this ruling, divides mining property into two classes: those which were purchased by mining corporations prior to January 1, 1909, and those which were purchased by mining corporations subsequent to that date. As to those purchased subsequent to that date, he allows no depreciation in excess of the actual cost of the property (section 105) "as profit arising in sale of such *capital assets* applies wholly to the period subsequent to January 1st, 1909." (Italics ours.)

Apparently the Commissioner confuses the term "profit" with the term "income." "Income" may necessarily be "profits;" but "profits" are not necessarily "income." The Commissioner uses the term "sale of *capital* assets," both in sections 100 and 105, from which it appears that the "profit" of which he speaks is in fact converted capital and not "income."

There is no authority in the act for limiting that which is in fact "depreciation" to the cost thereof; or, in the words of the Commissioner, "original capital investment cost" (section 97); but by section 105 the

Commissioner denies the right to deduct any values derived from newly discovered ore reserves, or from increased market value of the metals contained in the ore reserves known to exist at the time of the purchase of the property.

As to properties purchased prior to January 1, 1909, and owned by a mining corporation at that date, the Commissioner rules as follows:

To each ton of ore that was in sight on January 1, 1909, is allotted its proportionate part of the "capital investment cost of the property." The corporation is required to make a determination of the value of the tonnage known to exist on January 1, 1909, as of that date. The difference between the cost per ton, "on the basis of the original capital investment cost," and the value per ton as of date January 1, 1909, is designated "unearned increment" (section 99). Depreciation is allowed to the full extent of the "original capital investment cost." The unearned increment as of date January 1, 1909, is excluded from the computation of the gross income. Subsequently discovered ore bodies are to be excluded from the computation of gross income, their value being computed on the same basis per ton as the ore which was known to exist on January 1, 1909.

The result of this complicated calculation is, that if subsequently discovered ore bodies are worth more per ton than the ore known to exist on January 1, 1909, that excess of value is included in the gross income, and any increase in metal value is also to be included in the gross income. The gross income so computed is then made the basis for the tax.

We are not aware that this decision was ever successfully applied. We will not say that it is impossible of application, but we do say that any corporation could profitably pay the tax rather than employ the skilled assistance that would be necessary to arrive at the values upon which to base the application of the decision.

There is nothing in the act which limits income to that which is not "unearned increment," as defined in the Treasury Decision above quoted. Nor is there anything in the act which limits depreciation to property owned at any particular time, or to the actual cost of the property, or to any proportion of the values that might be realized from the sale of the property through ordinary operation of the same. The present significance of the complicated and confused distinction found in Treasury Decision No. 1742 is, that it so clearly demonstrates the early recognition by the administrative officers of the inaptness of the act, as applied to mining conditions.

THIRD

Mining Corporations Are Not Engaged in Carrying on Business within the Meaning of the Act.

The letter of the act includes "every corporation * * * having a capital stock represented by shares." The context of the act clearly shows that no corporation comes within its purview unless that corporation is engaged in or carrying on a business in a corporate capacity.

Flint vs. Stone Tracy Co., 220 U. S., 107.

Merely existing as a corporation and exercising corporate franchises does not necessarily amount to the "carrying on of business," within the intent of the act.

> McCoach vs. Minehill Ry. Co., 228 U. S., 295.
>
> Zonne vs. Minneapolis Syndicate, 220 U. S., 187.

The mere receipt of whatever is yielded by the usual and ordinary enjoyment of property, real or personal, does not of itself, constitute the doing of business.

> McCoach vs. Minehill Ry. Co., *supra.*
>
> Zonne vs. Minneapolis Syndicate, *supra.*

The terms "doing business", or "carrying on business", are not susceptible of exact definition. In the law of partnership they are sufficiently definite to admit of practical distinctions. If persons are "carrying on a common business with a view to profit," they are partners. If persons are *joint owners* of real property, operating and managing the same with a view to profit, but limiting their affairs to such things as are necessarily an incident of that ownership, they are not partners, because their association lacks the necessary element, to-wit, "the carrying on of business."

In Clark vs. Sidway, 142 U. S., 682, two persons were jointly engaged in the purchase and holding of land for speculative purposes. The court, through Mr. Justice Blatchford, thus interpreted the relation of the parties (at 690):

> "The transaction between Sidway and Clark, of their joint purchase of the land, did not constitute a co-partnership in respect thereto. It was a single, special adventure, on joint account, involving the payment, in equal proportions, of designated sums of money. It was a mere community of interest in the property, and the agreement to share the profits and losses of the sale of the land, did not create a partnership. The parties were only tenants in common, and the action at law would lie."

So in Farrand vs. Gleason, 56 Vt., 633, 637, the situation was summed up in the following language:

> "The parties agree to purchase certain property, and fit it up for certain purposes, and to be at equal expense in doing it, and to share equally the profits that may arise from selling or leasing the property. * * * All the provisions of these contracts, as well as all the conduct of the parties, are consistent with the tenancy in common in the property, while they lack many of the distinctive elements of a partnership therein, if not absolutely inconsistent therewith. We think that the defendant's contention (that the relation was a co-tenancy and not a partnership) must prevail, in regard to the relation of the orator's intestate to the defendant and the property in question, under these contracts, and the interpretation put upon

them by the conduct of the parties." (Matter in parenthesis ours.)

Jordan vs. Soule, 79 Me., 590; 12 Atl., 786.

Harris vs. de Raismes, 38 Atl. (N. J.), 637.

See, also, Nash vs. Mitchell, 71 N. Y., 199, where it was held that the management of her landed property by a married woman was not the carrying on of a trade or business, within the meaning of the statute authorizing married women to carry on trade or business. The court said (page 203):

> "The defendant was not carrying on a trade or business. The management of her landed property, the receipt of rents and income, and disposing of them, was not a trade or business, within the meaning of the statute enabling married women to carry on a trade or business. That statute has respect to business pursuits, mechanical, manufacturing or commercial. The care and supervision of lands and property owned by a *feme covert* is not the carrying on of a separate trade or business."

In the same way it has been recognized that a mining partnership is a non-trading partnership, and thus not carrying on business in the commercial sense.

Childers vs. Neely, 47 W. Va., 70; 34 S. E., 828: This case involved the peculiar nature and status of

a mining partnership. In reaching its conclusions, the court said (pages 72-74):

> "There is a peculiar partnership, called 'a mining partnership,' partaking partly of the nature of an ordinary trading or general partnership, on the one hand, and partly of a tenancy in common, on the other. * * *
>
> It is a rule that a non-trading partnership, as distinguished from a trading, commercial firm, does not confer the same authority, by implication, on its members, to bind the firm; as e. g. a partnership to run a theatre or other single enterprise only. A mining partnership is a non-trading partnership, and its members are limited to expenditures necessary and usual in the particular business."

In Judge vs. Braswell, 13 Bush (Ky.), 67, it is held that a mining partnership is a non-commercial partnership, and that one partner, therefore, has no power to bind the firm by purchasing land or drawing notes in its name.

Admittedly, traders, bankers, and those engaged in similar pursuits, devoting their efforts to the acquisition of earnings attributable in part to the use of their capital, but in a greater part to their individual skill and effort in buying and selling merchandise, loaning money, and generally being an agent of manufacture, trade, finance, and similar activities, are engaged in the "carrying on of business," and if they are so engaged jointly with others, they are partners. This is the most conspicuous case wherein the law has

for generations dealt with the distinction between those engaged in "carrying on business" and those not so engaged.

We submit that the distinction made in partnership law affords a practical test for determining under Section 38, what corporations are engaged in business, within the contemplation thereof. It is clear that a mining corporation is not engaged in trade, manufacture, transportation, banking, or any similar activity, for the purpose of profit. The mining corporation's activities are wholly devoted to the use of its property in the usual and ordinary way, and to the full realization of the benefits and advantages that may be derived therefrom. It *earns* nothing by its corporate activities. What it has on the completion of its operations is what it had at the beginning, but in another form.

In one salient respect the *corporate activities* of the mining corporation are of the same character as the *corporate activities* exercised by the corporations involved in the *Zonne* case and in the *McCoach* case, *supra*. In those cases the corporations were merely exercising the ordinary incidents of ownership of the properties which were theirs, and their income was that which was derived from the exercise of such ordinary incidents. They had no income derived from the employment of their corporate activities beyond the enjoyment as a corporation of the ordinary incidents of ownership of real property. We submit that mining corporations should be placed in a similar category.

FOURTH

The Application of the Act to Mining Corporations Results in a Tax upon the Capital Itself, While, as Applied to Corporations Having an Income, as Distinguished from Capital, It Does Not Result in a Tax upon Capital. This Inequality of Operation Is Inherently Unjust. Laying Aside All Questions of Constitutional Limitations, the Act Should Not Be so Construed as to Accomplish This Unjust Result, if There Be a Fair and Reasonable Construction to Be Given the Act Which Would Avoid Such an Unjust Result.

If the contention of the government be sustained, we shall have the following result: A mining corporation, having only its mining premises, will have paid to the government just 1 per cent of its capital assets—no more, and no less. Its capital assets will be worth to it just 99 per cent of their true value. A mercantile corporation which, by its corporate activities, produces a true "income," on the winding up of its business, will have paid to the government 1 per cent of that which it has during its business life acquired in excess of its capital, while its capital will remain intact. Such a condition, although it may fall more or less lightly upon the individual mining corporation, represents, in the gross, a glaring inequality and lack of uniformity in the operation of the act. We do not contend that such lack of uniformity makes the act unconstitutional. We do contend that such a palpable injustice in operation is a strong argument in support of our assertion that mining corporations were not in the legislative mind when Section 38 was enacted. It is a strong circum-

stance to be considered in connection with our contention that mining corporations are not within the spirit of the act. It is quite apparent that Congress intended to lay the tax provided in Section 38 uniformly upon all corporations to which they intended it to apply. The circumstance that the tax does not operate with uniformity on mining corporations is proof that the latter class were not to be included in the general classification.

> "When a court of law is construing an instrument, whether a public law or a private contract, it is legitimate, if two constructions are fairly possible, to adopt that one which equity would favor."

Washington & Idaho Railroad Company vs. Coeur d'Alene Railway & Navigation Company, 160 U. S., 77, at 101.

So in Bate Refrigerator Company vs. Sulzberger, 157 U. S., 1, Mr. Justice Harlan, on page 37, stated the rule in the following manner,

> "Undoubtedly the court, when endeavoring to ascertain the intention of the legislature, may be justified, in some circumstances, in giving weight to considerations of injustice or inconvenience that may arise from the particular construction of the statute."

FIFTH

The Proceeds of Mining Operations Do Not Represent Values Created by, or Incident to, the Business Activities of Such a Corporation, and Cannot Be a Bona Fide Measure of a Tax Leveled at Such Corporate Business Activities.

This court sustained Section 38 as a constitutional enactment, because it found the act to have for its object "taxation of the doing of business in a corporate capacity." The *Pollock* case condemned a tax upon income from property, real and personal. In that case the court established the principle that, for the purpose of determining whether or not a tax is direct, it will look "through the form to the substance." A tax upon the doing of business in a corporate capacity, *depending upon the value of the property owned by the corporation, as a basis of measurement of the tax*, would be a mere subterfuge, because the measurement of the tax would have no relation, primary or incidental, to the thing taxed, to-wit, the doing of business in a corporate capacity.

All of the reasons which impelled this court in Flint vs. Stone Tracy Co. to hold that the tax in question is in *fact* a tax upon the doing of business in a corporate capacity, and not a tax upon the property owned by the corporation, or the income therefrom, such as was condemned in the *Pollock* case, may not necessarily be expressed in the opinion in the *Flint* case. We can be certain, from a perusal of the brief filed by the distinguished and lamented Solicitor General who represented the government in that case, that certain reasons were urged why the tax in ques-

tion should be held to be in *fact* a tax upon the doing of business. On pages 10, 11, and 12 of the government's brief he said:

> " * * * but it may be said shortly * * * that measurement of a tax upon the transaction of business by some particular feature or *result of the business* not only is proper, but is necessary if the amount of tax on the business is to be determined in any more or less equitable way instead of being imposed arbitrarily. An excise on business of course can be fixed in its amount by the legislature itself, and so can even be made by the legislature the same for different kinds of business or for businesses of the same kind but different size; and unless some rule of measuring the tax by something else than the transaction of business, which is the subject of the tax, is prescribed by the legislature, the amount of tax must be directly and arbitrarily fixed by the legislature. That, however, is obviously unjust, unless the tax is to be of insignificant amount, because it takes no account of differences in volume or profitableness of business, and therefore wholly neglects the serviceableness of the taxed business to its proprietor and the ability of the taxpayer to meet the tax. * * * Net income from business has the business for its source; measures, not the mere size, but the profitableness of the business; measures therefore the utility to the taxpayer of that on which he is taxed, viz., the business;

> "* * * Finally, it is worth noting that measurement of a tax on business by its net income, besides being entirely consonant with the subject of the tax, carries no fair or real suggestion of a design to tax property. Net income, and even gross income, from business has no usual relation to the amount of property employed in the business, whether different sorts of business or the same business at different times be considered." (Italics ours.)

We submit that the argument just quoted was the strongest argument that could be presented in support of the contention that the tax in question is not a mere subterfuge for a direct tax, but is a *bona fide* excise laid upon the doing of business in a corporate capacity. That which unmistakably stamps it as an excise is the expressed intent of Congress to measure the tax upon the "doing of business in a corporate capacity" by the amount *earned* by the corporation, through the exercise of its corporate activities. Clearly, there is some relation between the thing taxed and the measure of the tax.

It must follow that, if the legislature intended to lay the tax upon those corporations which were engaged in carrying on business in a corporate capacity, and to measure that tax by the income produced by the exercise of such activities, it did not have in mind a mining corporation, whose corporate activities add nothing to the corpus of the capital with which it starts.

SIXTH

The Measurement of the Tax by the Excess of the Receipts for Ore Marketed over the Cost of Mining, Extracting and Marketing the Same Is Equivalent to a Tax upon the Usual and Ordinary Incidents of Ownership of Such Property—Such a Direct Tax as Is Prohibited by the Constitution—and, Further, Is Such a Tax as Congress, by the Provisions for the Deduction of Depreciation Provided in the Act, Expressly Intended to Levy.

What we have said under Subdivision Fifth is applicable under Subdivision Sixth.

There is a clear distinction between the *doing* of a thing by the exercise of corporate activities, and the *acquiring* of a thing by the exercise of corporate activities. We cannot deny that mining corporations convert their ores into cash, and other things of value, by the exercise of corporate activities, but it cannot be contended that a mining corporation acquires anything of value as an addition to, or in excess of, its capital assets by the exercise of such activities.

There is no distinction, in fact, between a tax of 1 per cent on the value of mining property owned by a corporation, and a tax of 1 per cent on those parts of that property which may from time to time be extracted and sold in the ordinary use and customary enjoyment of such property. Congress might have fixed the tax as a percentage of the gross income of ordinary corporations, but the gross income of the ordinary corporation contains a factor produced by the destruction or depreciation of capital. It is fair to presume that the measure actually adopted by

Congress, and which eliminates the depreciation of capital, was adopted for the deliberate purpose of excluding from consideration, as a basis for the tax, any part of the capital which might find its way into the income column, in order that the law might not be tainted by the presence of any component element characteristic of a direct tax. Any corporation whose affairs are such that in its receipts can be found nothing but capital in a converted form is clearly not within the purview of the act. As applied to such a corporation, the tax cannot be said to be a tax upon the doing of business in a corporate capacity, but, whatever it may be called, it is in fact a direct tax. If we follow the argument of the *Pollock* case, and disregard the nomenclature in determining the classification of the tax, the criterion would be: "Is the method of measuring the tax based upon a valuation incident to the property itself, or is it based upon a valuation incident to the thing taxed?" If it be based upon a valuation incident to the property itself, then it is a tax on the property itself; if it be based upon a valuation incident to the doing of business—i. e., the earning power of the business activities—then it is a tax upon the doing of business in a corporate capacity.

Knowlton vs. Moore, 178 U. S., 41, 81-82.

In the case of mining corporations, all that is found in the column treated by the government as "gross income" is produced by conversion of the capital. The ultimate measure of the tax is the value of the property itself. Congress did not intend to lay a direct tax, measured by the value of the property owned and used by the corporation; or to include

within the purview of the act any corporation whose tax could not be determined except by taking a percentage of the value of the property itself. It certainly did not intend to include a corporation whose entire receipts are the result of capital depreciation.

SEVENTH

The Proceeds of Mining Operations Result from a Conversion of the Capital Represented by Real Estate into Capital Represented by Cash, and Are in No True Sense Income. The Act Cannot Apply to a Corporation Which Has No Income.

Subdivision Seventh covers the same subject-matter that will be discussed more at length under the second certified question. This subdivision is but another way of presenting the conclusions for which we there contend. The act is confined to corporations having an income, and if we be correct in our contention under the second certified question, that mining corporations have no income, then clearly the act does not apply to mining corporations.

EIGHTH

The Act Ought Not to Be Construed to Include Mining Corporations Unless It Clearly Appears that Congress Intended to Include Them. It Is an Established Canon of Construction in This Court that "Duties Are Never Imposed on the Citizen upon Vague or Doubtful Interpretations."

In determining whether mining corporations were within the legislative mind when Section 38 was

enacted, the act should not be construed to include mining corporations unless it clearly appears that it was the intention of Congress to include them. The language of this court in Hartranft vs. Wiegemann, 121 U. S., 609, at 616 (quoted above), is applicable to this case.

In construing the act here in question, as being inapplicable to receivers, the Circuit Court of Appeals of the Second Circuit said, in Pennsylvania Steel Co. vs. New York City Rys. Co., 198 Fed., 774, at 775:

> "The Act in question, levying, as it does, a tax upon the citizen, must be strictly construed; it cannot be enlarged by construction to cover matters not clearly within its purport. The question is not what Congress might have done or should have done, but what it actually did do."

See also:

Taylor vs. Treat, 153 Fed., 656.

Parkview Building & Loan Ass'n. vs. Herold, 203 Fed., 876, 880.

NINTH

The Fact that Mining Corporations Come within the Letter of the Act, if True, Does Not Conclude the Argument; for, if Mining Corporations Be Not within the Spirit of the Act, It Is Not Applicable to Them.

We are convinced that it is only by the merest accident that the administrative officers have any

ground for the contention that mining corporations are subject to the provisions of the act. The opening provisions of Section 38 refer to "every corporation," but we have tried to show that the economics of the act, when applied to mining corporations, are a total mistit. After the decision in the *Pollock* case, the course of Congress was clearly mapped out, and the line of that course lay outside and beyond mining corporations. The things which they were authorized to tax do not exist in connection with mining corporations. It is apparent from the ways they provided for the measurement of the tax that they had not in mind mining corporations with their various economic anomalies.

We submit that the decisions of this court in Brewer's Lessee vs. Blougher, 14 Pet., 178; U. S. vs. Kirby, 7 Wall., 482, 486; Heydenfeldt vs. Daney Gold & Silver Mining Co., 93 U. S., 634, 638, and Holy Trinity Church vs. U. S., 143 U. S., 457, furnish the rule applicable to the situation now before us.

In the first of these cases Chief Justice Taney, in construing an act relating to inheritance, said (at page 198):

> "It is undoubtedly the duty of the Court to ascertain the meaning of the legislature, from the words used in the statute, and the subject matter to which it relates; and to restrain its operations within narrower limits than its words import, if the Court are satisfied that the literal meaning of its language would extend to cases which the legislature never designed to embrace in it."

And in the *Trinity Church* case, Mr. Justice Brewer summed up the principle (at page 459), as follows:

> "It is a familiar rule, that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers. This has been often asserted and the reports are full of cases illustrating its application. This is not the substitution of the will of the judge for that of the legislator, for frequently words of general meaning are used in a statute, words broad enough to include an act in question, and yet a consideration of the whole legislation, or of the circumstances surrounding its enactment, or of the absurd results which follow from giving such broad meaning to the words, makes it unreasonable to believe that the legislator intended to include the particular act."

"II. ARE THE PROCEEDS OF ORES MINED BY A CORPORATION FROM ITS OWN PREMISES INCOME WITHIN THE MEANING OF THE AFORE-MENTIONED ACT OF CONGRESS?"

Under the second subdivision of the argument on the first question, we refer to the attitude at first taken by the Commissioner of Internal Revenue, as disclosed by Treasury Decision No. 1742. In that decision, the Commissioner recognized that the tax

ought not to be paid on all the net proceeds derived from the sale of ores mined. He expressly excluded what he called the "unearned increment" from the computation of "gross income." But this policy was only applied to mines purchased prior to January 1st, 1909. As to properties acquired after that date, no exclusion of "unearned increment" was permitted by the decision. As above stated, the Commissioner does not now follow that decision. Proceeds of ores mined and sold are now classed as "gross income." It is noticeable that in that decision, in two sections—Sections 100 and 105—he speaks of the proceeds as arising from the sale of, disposal of, or profits arising from, "*capital assets.*" It must be the fact, as the Commissioner recognized by such language, that the business of mining companies consists primarily in the conversion of capital, and not in the creation of income. No doubt the Commissioner aimed to reach the "profits or gains" of mining operations and devised the scheme outlined in Treasury Decision 1742 to exclude "original capital investment cost" and catch the profits.

As we see the fallacies of the government's position they are these: First, it fails to recognize the results of the fact that the corpus of mining premises constitutes capital, and that such is the fact, regardless of cost price, present value, known or unknown value, increase in value, or extension or contraction of the corpus; second, it fails to recognize the fact that proceeds of the sale of capital assets can be nothing but capital; third, it confuses the meaning of the word "profits" with the meaning of the word "income."

We submit that a correct definition of the word "income" was given in the case of People ex rel. Cornell University vs. Davenport, 30 Hun., 177, at 180, as follows:

> "The income, as above said, from an investment, is that which it earns, remaining itself intact."
>
> Quoted and approved in Thorne vs. de Bretenil, 86 App. Div., 405, at 416.

In the case of Wilcox vs. County Commissioners of Middlesex, 103 Mass., 544, at 546, the court, considering the meaning of the term "income," as used in the Massachusetts income tax law, said:

> "The income meant by the statute is the income for the year, and is the result of the year's business. It is the net result of many combined influences: the use of the capital invested; the personal labor and services of the members of the firm; the skill and ability with which they lay in, or from time to time renew, their stock; the carefulness and good judgment with which they sell and give credit; and the foresight and address with which they hold themselves prepared for the fluctuations and contingencies affecting the general commerce and business of the country. To express it in a more summary and comprehensive form, it is the *creation* of capital, industry, and skill." (Italics ours.)

The active idea of "earning" and "creating" is dominant in the meaning of the word "income." We submit that it is in this active sense that the word is used in the act in question. "The doing of business in a corporate capacity"—the active agency of the earning or creation—is the thing taxed, and the measure of the thing taxed—"income"—is the product of that activity.

In the case of Sargent Land Co. vs. Fred Von Baumbach, Collector, in the District Court of the United States, for the District of Minnesota, decided in August, 1913, Judge Willard considered and passed upon the identical question which is here involved, and held that the proceeds of mining operations are not income, within the meaning of Section 38, using the following language:

> "What does the word 'income' mean? In ordinary speech, people recognize a difference between 'capital' and 'income.' I believe that the ordinary meaning attached to 'income' when it is not derived from personal exertion, is that it is something produced by capital, without impairing that capital, and which leaves the property intact, and that nothing can be called 'income' for the purpose of this act which takes away from the property itself. If it does, then it ceases to be income and amounts to a sale of capital assets."

We are not concerned with the question whether "income" must necessarily be "profits." We are concerned with the theory upon which the Commissioner

of Internal Revenue has proceeded, that "profits" are necessarily "income." A mining property may be purchased by a mining corporation, and the corpus of that property will then represent its capital. Many contingencies may increase the value of the known ore bodies, and many contingencies may disclose additional ore contents; but whatever increase or diminution there may have been in the true value or the known value of it there has been no change in the corpus, there has been no change in the capital. Such a property purchased for $1,000 may develop into a property worth $1,000,000. The increased value may, in a sense, represent profits, but in no sense does it represent income, because it does not represent any physical addition to the original corpus of the capital.

In the case of Gray vs. Darlington, 15 Wall., 63, this court had under consideration a state of facts arising out of the attempted application of the Civil War income tax (Act of Congress, March 3, 1865). The act read that the tax "herein provided for shall be assessed, collected and paid upon the *gains, profits and income* for the year ending," etc. (Italics ours.) The owner of certain United States treasury notes exchanged them for United States five-twenty bonds, in the year 1865, and later, in the year 1869, sold the bonds at an advance of $20,000 over the original cost. The United States revenue collector collected a tax of $1,000, on the theory that the increased value of the bonds was taxable under the act. The tax being paid under protest, the owner of the bonds brought suit against the collector to recover the tax so paid. This court allowed the recovery, on two grounds: first, that the increased value of the bonds did not represent

"gains, profits and income," derived during any one year, and, second, that advance in value does not constitute "gains, profits or income." The court, speaking by Justice Field, said (page 65):

> "The advance in the value of property during a series of years can in no just sense be considered the gains, profits or income of any one particular year of the series, although the entire amount of the advance be at one time turned into money by a sale of the property. The statute looks, with some exceptions, for subjects of taxation only to annual gains, profits and income. Its general language is 'That there shall be levied, collected and paid annually upon the *gains, profits and income of every person*' derived from certain specified sources, a tax of five per cent., and that this tax shall be 'assessed, collected and paid upon the gains, profits and income for the year ending the 31st of December next preceding the time for levying, collecting and paying said tax.' * * *
>
> The mere fact that property has advanced in value between the date of its acquisition and sale, does not authorize the imposition of a tax on the amount of the advance. Mere advance in value in no sense constitutes the gains, profits or income specified by the statute. It constitutes and can be treated merely as increase of capital." (Italics ours.)

Attention may also be called to the broad language of this act of 1867—"gains, profits and income"

—as contrasted to the single term "income" in the present act.

So in Spooner vs. Phillips, 62 Conn., 62, at 68; 24 Atl., 521, at 525, the Connecticut Supreme Court of Errors said:

> "The word 'dividends,' if unqualified, signifies dividends payable in money. The word 'income' has a broader meaning, but hardly broad enough to include things not separated in some way from the principal. It is not synonymous with 'increase.' The value of stock may be increased by good management, prospects of business, and the like, but such increase is not income. It may also be increased by an accumulation of surplus; but so long as that surplus is retained by the corporation, either as surplus or increased stock, it can in no proper sense be called 'income.' It may become income-producing, but it is not 'income.'"

It seems indisputable that mere increase in value does not create income. Nor does the sale of property constituting capital, at a price over and above its cost, make income out of those gains which were not theretofore income.

The mining and sale of ore is nothing more nor less than a sale of a part of the capital. The result of the mining is to deplete the corpus of the capital represented by real estate, replacing it with money or some other value.

In Foster vs. Hart Mining Company, 52 Colo., 459, at 467-468, the court says:

> "Generally speaking, mines producing the precious metals are only valuable for the ores they contain. Such value, intrinsically, is limited to the net value of such ores; that is, what is realized from their sale and reduction after the expense of extracting, reducing and shipping them to market is deducted. * * * Mines are valuable only by extracting their values. Each ton of ore extracted reduces by that much the value of the property from which it is taken. Sooner or later the ore bodies in a property being operated will be exhausted, and what then remains is generally worthless."

In Smith vs. Hooper, 95 Md., 16, at 26-27; 51 Atl., 811, at 816, the court was considering the respective rights of a life tenant and remainder man in a trust estate, and was called upon to consider whether the proceeds of the sale of a certain part of the capital of the estate should be treated as income or capital. In this connection it was said:

> "The conversion of some of the shares into money resulted merely in substituting the cash received for the shares thus sold; and if the unsold shares represented nothing but capital, though capital of a largely increased value, the money obtained for the same shares when sold can represent nothing but capital either." * * * That there has been a marvelous *increase* of the fund is manifest. Is that increase *income?* Increase and income are not synonymous terms. Until

> detached or separated from the shares whose value it enhances, increase forms part of that value, and, therefore, part of the shares; and if it be part of the shares themselves then, whilst it may be *profit*, it is in no sense income."

In the case of Vinton's Appeal, 99 Pa. St., 434, in a controversy between a life tenant and remainder man of a trust estate consisting of certain shares in a corporation, as to the ownership of a cash dividend, resulting from a sale of a part of the corpus of the property, the court said, at page 441:

> "It is thus manifest that the money in dispute comes not from the annual earnings of the company, but from a sale of part of its property, part of that very corpus which the stock shares represent, and without which those shares have neither substance nor value;"

concluding that such dividend was properly a part of the capital of the trust estate.

See also:

> In re Mount Alto Iron Company, 174 Pa. St., 430; 34 Atl., 638.
>
> Mercer vs. Buchanan, 132 Fed., 501, at 507-508.

In re Armitage, (1893) 3 Ch. Div., 337, involved a similar question. A company in which 8*l*. had been paid in upon 10*l*. shares was wound up, and the share-

holders received 9*l.* 5*s.* 6½*d.* The question arose as to whether this difference of 1*l.* 5*s.* 6½*d.* was capital, or income, such as should go to the life tenant of the trust. The conclusions of the court are summed up in a terse statement by Lord Justice Lopes, at page 347:

> "I come to the conclusion, beyond any doubt, that this excess is to be regarded as capital, and not as income, and is not to go to the tenant for life. There is an argument in support of this view to which no answer has been given. It is admitted that if these shares had been sold by the executors for 9*l.* 5*s.* 6½*d.* per share, before this sale *en masse* of all the shares, to the new company, the excess of 1*l.* 5*s.* 6½*d.* per share would have been regarded as capital, and would not have gone to the tenant for life. How does the fact that there has been a sale to this new company, instead of an ordinary sale, in the market, by the executors, convert that which would otherwise be regarded as capital into income? I am unable to answer that question when I put it to myself, and the learned counsel for the Respondents have not answered it in any way satisfactory to my mind."

The philosophy of Section 38 excludes the idea of a tax upon the property itself, or upon that which is the same thing—the value that may be substituted upon a sale or exchange of that property. The tax is laid upon that which is created by the business ac-

tivity, and which has a separate corpus apart from the corpus of the capital, which must remain intact. No one would contend that if the entire capital assets of the corporation were sold *en masse*, the consideration received therefor could properly be designated and classified as "income." But clearly under the principle of the *Doyle-ton* case, *supra*, mere increase in value of the capital does not create income. Nor does such increase in value, followed by a liquidation of that increased value, through a sale of the capital at an increased price, produce income. The reason which justifies this conclusion applies with equal force when the capital is sold piecemeal, as in mining operations; for the conclusion depends upon the incontestable fact that the thing sold is capital, and the thing received for it takes its place. There is no logical process by which a mere difference in time, place, or manner of sale can alter the proper classification of the proceeds. Certainly the method of sale—whether *en masse* or in parcels—cannot form the criterion by which the existence of income is to be determined.

We submit that the proceeds of mining operations are in no sense "income," within the meaning of the act.

"III. IF THE PROCEEDS FROM ORE SALES ARE TO BE TREATED AS INCOME, IS SUCH A CORPORATION ENTITLED TO DEDUCT THE VALUE OF SUCH ORE IN PLACE AND BEFORE IT IS MINED AS DEPRECIATION WITHIN THE MEANING OF SECTION 38 OF SAID ACT OF CONGRESS?"

Section 38 of the act in question provides:

> "Such net income shall be ascertained by deducting from the gross amount of the income of such corporation * * * received within the year from all sources, * * * (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, * * * "

Assuming, then, that the proceeds of ore are to be treated as income within the meaning of the act, we submit that such proceeds result solely from depletion of capital, and are therefore deductible as depreciation under the provision set out above.

The term "property," as here used, is obviously synonymous with the term "capital;" for the property of any corporation is at least a part of its capital, and of a mining corporation is practically its entire capital.

The government apparently proceeded at first upon the theory that there must be a limit upon the depreciation to be allowed to a mining corporation. In the administration of the act, different ideas seem to have prevailed in different places. By some it was contended that the limit should be the cost of the

mining premises and improvements. By others it was contended that the limit should be the capitalization of the company. Neither of these tests reaches the value of the substance of the corpus of the capital. There is nothing in the act which indicates that as to any corporation there shall be any limit of depreciation. The act provides for the deduction of "depreciation," and what is "depreciation" is a question of fact. When in any year the corpus of the capital has depreciated, then there has been depreciation to deduct. Capital is a tangible, definite thing, quite distinguishable from cost of capital, or from par value of authorized capital.

Deduction for "reasonable depreciation" is allowed. Nowhere in the act is any authority given for arbitrary administrative exclusion of that which is actual depreciation. And we contend that, if a part of the capital assets are removed and sold, the property, as it originally stood, is actually depreciated in value to the exact extent of such removal.

As an actual matter of experience, the original cost of the property must, from its very nature, be highly speculative. The values in the property are invisible and impossible of determination. They may be worth many times the cost or they may be worth nothing. We submit, therefore, that any such basis of capitalization is purely fictitious, and this contention is sustained by the manner in which mining companies are capitalized.

A. Leschen & Sons Rope Co. vs. Allen, 187 Fed., 977.

In re South Mountain Consolidated Mining Co., 14 Fed., 327.

The value of the ore in sight does represent a part of the capital but there is no warrant for limiting it to this amount, nor is there any warrant for limiting the value of ore bodies thereafter discovered in any case to a standard fixed before their discovery, and therefore of necessity, purely conjectural. This was however announced by Treasury Decision 1742.

The true capital of a mining corporation is the true value of the minerals within the limits of its properties. Irrespective of developed ore bodies or those known to exist at any one moment. Investigation or development may demonstrate the existence of values theretofore unknown, but this results in no addition to the actual capital. It remains the same as it was before.

This principle was recognized and acted upon in a case involving similar facts under the law now in question:

U. S. vs. Nipissing Mines Co., 202 Fed. 865.

Judge Learned Hand in U. S. vs. Nipissing Mines Co. in instructing a verdict for the defendant:

"Now it is quite conceivable that it should make no difference, that one cannot tell with reasonable certainty the total value of the deposit so long as the value of the amount to be moved to-day can be ascertained with sufficient accuracy. Now it is quite clear that the privilege is allowed in aid of the circumstance that the [illegible] was bought at a very high or at a very low price

> or that the capitalization of the company which owns it is large or small."

From this it follows that whenever ore is extracted the capital is depleted the more ore removed, the less remains. Excavation and removal may disclose new bodies, but there is no increase of capital thereby. It is submitted that the conclusion is well grounded that such extraction and sale of ore constitutes depreciation, within the meaning of the act.

As was said by the court in U. S. vs. Nipissing Mines Co., *supra*, at pages 804-805:

> "This unit of value, 31.1 cents, multiplied by the total amount of ore that was removed during the year, indicates in dollars the amount by which the total assets of this company were depleted through the operation of the mine during that year. It seems to me to be a reasonable allowance for depreciation within the meaning of the statute. Certainly so much value has been eliminated from the property of the company forever. * * * It makes no difference that, in filling up the form of return under the direction of the revenue officers, this claimed allowance was called 'return of capital,' which it certainly is *not*, instead of 'depreciation of deposits,' which it clearly is."

Thus the ore removed during the course of any one year, being gone forever, should be held to represent the depreciation of the capital for that year, that being the actual, and hence the reasonable, depreciation for which the act provides. Just so long

as ore remains to be taken out there is capital to be depreciated, and when every ounce of ore has been removed, "what then remains is generally worthless." The company has entirely disposed of the property representing its capital by a depletion process.

If it be argued that the proceeds of the sales of ore are "return of capital," the same reasoning must apply. By allowing for depreciation, Congress evidently intended to avoid any tax on that part of the capital of any company which may find its way into income. In other words, to avoid any tax on converted capital. If a corporation has consumed or indirectly converted a certain portion of its capital in any one year, and is allowed to set aside a fund for replacement in its tax return, it logically follows that a corporation which has directly converted any portion of its capital into cash should be allowed to deduct the sum so received, as depreciation.

It is submitted, therefore, that a mining corporation is entitled to deduct as depreciation the value in place of the ore removed and sold during any particular year.

In the motion to advance this case for hearing it is stated that there are a large number of cases awaiting the answer to the foregoing certified questions. There is one type of these cases which we wish to call to the court's attention; those cases wherein the mining premises were purchased prior to the first day of January, 1909, on which date the act went into effect.

This type, which is not intended to comprehend all of the various questions presented in these cases,

presents some special features which are not present in the case now before the court.

As to mining premises purchased by a corporation prior to January 1, 1909, if the court finds that the act in question does not apply to mining corporations, or that the proceeds of mining operations are not income within the meaning of the act, or that the proceeds of a mine, being income within the meaning of the act, are entitled to a deduction against their gross value of their value in place before they were mined, as a depreciation, any one of such conclusions would meet the necessities of the case in question. If, however, the court should hold that Section 38 of the act does apply to mining corporations, and that the proceeds of mining operations are income within the meaning of the act, and that the value of the ores extracted when in place cannot be deducted as depreciation, a further argument ought to be considered on behalf of a corporation so situated in order to meet the special situation so presented: It should be remembered that if premises so purchased before January 1, 1909, turn out thereafter to be profitable, such gain or profit should be considered as having accrued prior to the taking effect of the act, and that operations subsequent to January 1, 1909, have not created such profit, but merely realized the profits already created by the good bargain by which the property was so acquired at less than its actual value. This profit having been created prior to January 1, 1909, would thus be neither subject to taxation nor a measure by which the year's income could be tested to ascertain the tax. Such a case would be, no doubt, governed by the principles announced in Gray vs. Darlington, 15 Wall., 63, already discussed in this brief. The justice

of this contention seems to have been recognized in Treasury Decision No. 1742, and if that decision were now applied, it would reach practically the same result.

It has been suggested on the part of the government that, as a last resort, it may fix as a limit of depreciation of mining properties the known value of the mine on January 1, 1909, and there are many cases wherein the annual tax has been exacted, notwithstanding the fact that the net production of the properties in question has not equaled such known value as of January 1, 1909.

We call these questions to the attention of the court. If we are correct in the conclusions which we have submitted, these cases will be covered by the answers. If we be not correct in the broad ground which we have advanced, it is the wish of those vitally interested in the other and narrower questions which may be presented, that the court may be advised of the existence of such controversies.

We respectfully submit:

First—That Section 38 of the act in question does not apply to mining corporations.

Second—That the proceeds of mining operations are not "income" within the meaning of the act.

Third—That, if such proceeds are held to be income within the meaning of the act, then the value of the ores extracted, when in place, should be deducted as depreciation before the tax is computed.

Respectfully submitted,

WILLIAM V. HODGES,
Attorney for Stratton's Independence, Limited.

APPENDIX 1

AN ACT TO PROVIDE REVENUE, EQUALIZE DUTIES, AND ENCOURAGE THE INDUSTRIES OF THE UNITED STATES, AND FOR OTHER PURPOSES.

Approved August 5, 1909 (36 Statutes at Large, page 11).

SEC. 38. That every corporation, joint stock company or association, organized for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States or of any State or Territory of the United States or under the acts of Congress applicable to Alaska or the District of Columbia, or now or hereafter organized under the laws of any foreign country and engaged in business in any State or Territory of the United States or in Alaska or in the District of Columbia, shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation, joint stock company or association, or insurance company, equivalent to one per centum upon the entire net income over and above five thousand dollars received by it from all sources during such year, exclusive of amounts received by it as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax thereby imposed; or if organized under the laws of any foreign country, upon the amount of net income over and above five thousand dollars received by it from business transacted and capital invested within the United States and its Territories, Alaska, and the

District of Columbia during such year, exclusive of amounts so received by it as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax thereby imposed; provided, however, that nothing in this section contained shall apply to labor, agricultural or horticultural organizations, or to fraternal beneficiary societies, orders, or associations operating under the lodge system, and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders, or associations, and dependents of such members, nor to domestic building and loan associations, organized and operated exclusively for the mutual benefit of their members, nor to any corporation or association organized and operated exclusively for religious, charitable, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual.

Second. Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint stock company or association, or insurance company, received within the year from all sources, (first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, and in the case of insurance companies the sums other than dividends, paid within the

year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve funds; (third) interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year, and in the case of a bank, banking association or trust company, all interest actually paid by it within the year on deposits; (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the government of any foreign country as a condition to carrying on business therein; (fifth) all amounts received by it within the year as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax hereby imposed; provided, that in the case of a corporation, joint stock company or association, or insurance company, organized under the laws of a foreign country, such net income shall be ascertained by deducting from the gross amount of its income received within the year from business transacted and capital invested within the United States and any of its Territories, Alaska, and the District of Columbia, (first) all the ordinary and necessary expenses actually paid within the year out of earnings in the maintenance and operation of its business and property within the United States and its Territories, Alaska, and the District of Columbia, including all charges such as rentals or franchise payments required to be made as a condition to the continued use

or possession of property; (second) all losses actually sustained within the year in business conducted by it within the United States or its Territories, Alaska, or the District of Columbia not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, and in the case of insurance companies the sums other than dividends, paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve funds; (third) interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness, not exceeding the proportion of its paid-up capital stock outstanding at the close of the year, which the gross amount of its income for the year from business transacted and capital invested within the United States and any of its Territories, Alaska, and the District of Columbia bears to the gross amount of its income derived from all sources within and without the United States; (fourth) the sums paid by it within the year for taxes imposed under the authority of the United States, or of any State or Territory thereof; (fifth) all amounts received by it within the year as dividends upon stock of other corporations, joint stock companies or associations, and insurance companies, subject to the tax hereby imposed. In the case of assessment insurance companies the actual deposit of sums with State or Territorial officers, pursuant to law, as additions to guaranty or reserve funds shall be treated as being payments required by law to reserve funds.

Third. There shall be deducted from the amount of the net income of each of such corporations, joint

stock companies or associations, or insurance companies, ascertained as provided in the foregoing paragraphs of this section, the sum of five thousand dollars, and said tax shall be computed upon the remainder of said net income of such corporation, joint stock company or association, or insurance company, for the year ending December 31, 1909, and for each calendar year thereafter; and on or before the first day of March, 1910, and the first day of March in each year thereafter, a true and accurate return under oath or affirmation of its president, vice president, or other principal officer, and its treasurer or assistant treasurer, shall be made by each of the corporations, joint stock companies or associations, and insurance companies, subject to the tax imposed by this section, to the collector of internal revenue for the district in which such corporation, joint stock company or association, or insurance company, has its principal place of business, or, in the case of a corporation, joint stock company or association, or insurance company, organized under the laws of a foreign country, in the place where its principal business is carried on within the United States, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, setting forth, (first) the total amount of the paid-up capital stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year; (second) the total amount of the bonded and other indebtedness of such corporation, joint stock company or association, or insurance company, at the close of the year; (third) the gross amount of the income of such corporation, joint stock company or

association, or insurance company, received during such year from all sources, and if organized under the laws of a foreign country the gross amount of its income received within the year from business transacted and capital invested within the United States and any of its Territories, Alaska, and the District of Columbia; also the amount received by such corporation, joint stock company or association, or insurance company, within the year by way of dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax imposed by this section; (fourth) the total amount of all the ordinary and necessary expenses actually paid out of earnings in the maintenance and operation of the business and properties of such corporation, joint stock company or association, or insurance company, within the year, stating separately all charges such as rentals or franchise payments required to be made as a condition to the continued use or possession of property, and if organized under the laws of a foreign country the amount so paid in the maintenance and operation of its business within the United States and its Territories, Alaska, and the District of Columbia; (fifth) the total amount of all losses actually sustained during the year and not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in the case of insurance companies the sums other than dividends, paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve funds; and in the case of a corporation, joint stock company or association or insurance company, organ-

ized under the laws of a foreign country, all losses actually sustained by it during the year in business conducted by it within the United States or its Territories, Alaska, or the District of Columbia, not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in the case of insurance companies the sums other than dividends, paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve fund; (sixth) the amount of interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year, and in the case of a bank, banking association or trust company, stating separately all interest paid by it within the year on deposits; or in the case of a corporation, joint stock company or association, or insurance company, organized under the laws of a foreign country, interest so paid on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the proportion of its paid-up capital stock outstanding at the close of the year, which the gross amount of its income for the year from business transacted and capital invested within the United States and any of its Territories, Alaska, and the District of Columbia, bears to the gross amount of its income derived from all sources within and without the United States; (seventh) the amount paid by it within the year for taxes imposed under the authority of the United States or any State or Territory thereof,

and separately the amount so paid by it for taxes imposed by the government of any foreign country as a condition to carrying on business therein; (eighth) the net income of such corporation, joint stock company or association, or insurance company, after making the deductions in this section authorized. All such returns shall as received be transmitted forthwith by the collector to the Commissioner of Internal Revenue.

APPENDIX II.

TREASURY DECISION No. 1742.

DEPRECIATION IN COALS, MINERALS, ETC.

96. In case of corporations whose business consists in part or wholly of mining, producing, and disposing of deposits of nature (ores, coals, and sundry minerals) the conduct of such business will be understood to comprehend two classes of gains or losses, viz.:

(a) The gain or loss resulting from the sale of capital assets, i. e., either the increment, or the loss, arising through possessing over a period of time the investment in the same.

(b) The trading or commercial gain attached to the conduct of the industry, the employment of working capital, the effort and risk involved.

97. In the ascertainment of net income deduction will be allowed for depreciation arising from exhaustion of deposits of ore, mineral, etc., and for depreciation and obsolescence of improvements, in accordance with general regulations respecting depreciation allowances, *on the basis of the original capital investment cost of the properties concerned to the company reporting.*

98. *A further deduction will also be allowed, through not including the same at all in the item of gross income* (item 3, Form 637), for the unearned increment represented in such properties as at January 1, 1909, which will be determined in general as follows:

99. An estimate should be made as of January 1, 1909, of the fair market value at that date of the min-

erals, etc., in deposit. This estimate should be formed on the basis of the disposal value of the minerals *in total* and exclusive of value of improvements and development work. This valuation should also be reduced to a unit value—per ton, pound, etc.

Note—Values, as aforesaid, should not be estimated on the basis of the assumed salable value of the output under current operative conditions, less the actual cost of production, because, as hereinbefore stated, the selling price under such conditions comprehends a profit both for carrying the investment in minerals, improvements, and working capital, and for conducting operations in respect of production and disposal of product. The value to be determined as stated must be on the basis of the salable value of the entire deposit of the aggregate units of minerals considered *en bloc* if disposed of in that form. Nor must such valuation comprehend any speculative value which might attach to a sale of the minerals *en bloc*, i. e., a value which might be obtained on the ground that the future would develop a much greater reserve of mineral deposits than were believed to exist at the time estimate as of January 1, 1909, was formed. Any value of this latter character would attach obviously to such additional reserves when developed in future.

100. The unit value as of January 1, 1909, ascertained as above outlined, would indicate the value to be attached at that date to the capital assets disposed of during any calendar year succeeding, and should be used in determining the unearned increment at January 1, 1909, which may be excluded entirely from the item of gross income, as before explained, in the following manner, viz.:

Value at January 1, 1909, determined in manner outlined, of minerals, etc., which may be removed and disposed of in any year subsequent thereto ..... $——

Less the following:

(a) Proportion of depreciation charge applying to exhaustion of minerals disposed of, ascertained as first explained herein on basis of original cost ..... $——

(b) Royalty paid, if any, on minerals disposed of..... —— ——

Balance being unearned increment at January 1, 1909, to be excluded from gross-income item ..... ——

101. The precise detailed manner in which the estimate of value of minerals, etc., as at January 1, 1909, shall be formed, must naturally be determined upon by each corporation interested, but formal record of such estimates, together with all sustaining information, should be carefully filed so as to be readily accessible for reference. Values as stated, as determined at January 1, 1909, should be used in compilation in all subsequent years' excise-tax returns. The question as to whether it subsequently develops the property possessed a greater quantity of mineral, etc., reserve than was in the aggregate estimated as of January 1, 1909, is immaterial. *Any excess which may be developed will be considered as possessing the same value*

at January 1, 1909, as that which then may have been known to be in the property.

102. Each excise-tax return (Form 637) should be accompanied with memorandum setting forth the extent in amount of the exclusion made from the item gross income for unearned increment realized during the year, as above outlined.

103. As the amount to be deducted for depreciation (paragraph 2 preceding) is to be formed on basis of the estimated reserve of minerals, etc., it follows that if it develops such estimate is understated, the cost investment in the capital asset may be wholly extinguished before all mineral reserves are removed. When this is reached, further deductions for exhaustion of minerals should be discontinued, but in such event, it will be noted, the allowance for unearned increment which is to be excluded entirely from gross income will be correspondingly increased.

104. In case of corporations leasing mines and paying royalties on minerals, etc., removed, the royalties paid are to be treated as expenses and deducted in ascertaining net income, as provided in general regulations. Any leasehold investment which the operating corporation may have in such properties, either through a payment originally made for acquirement thereof or for improvements made upon the property, to be accounted for in accordance with regulations governing depreciation allowances and disposition of capital assets.

105. In respect to properties of the character in question which may be acquired by a corporation after January 1, 1909, a deduction will be allowed only as to depreciation arising from exhaustion based on original

cost; no exclusion from gross income can be made for unearned increment, as profit arising in sale of such capital assets applies wholly to the period subsequent to January 1, 1909.

December 15, 1911.

No. 457.

In the Supreme Court of the United States.

OCTOBER TERM, 1913.

STRATTON'S INDEPENDENCE, LIMITED,

v.

F. W. HOWBERT, COLLECTOR OF INTERNAL REVENUE WITHIN AND FOR THE DISTRICT OF COLORADO.

ON A CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF FOR F. W. HOWBERT, COLLECTOR.

WASHINGTON : GOVERNMENT PRINTING OFFICE : 1913

INDEX

CASES CITED.

In the Supreme Court of the United States.

OCTOBER TERM, 1913.

STRATTON'S INDEPENDENCE, LIMITED, *v.* F. W. HOWBERT, COLLECTOR OF INTERNAL REVENUE within and for the District of Colorado.	No. 457.

ON A CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF FOR F. W. HOWBERT, COLLECTOR.

STATEMENT OF CASE.

This was an action brought by an English corporation engaged in the business of mining in Colorado to recover certain moneys paid by it under the corporation-tax act. (36 Stat., 11, 112.) The case was tried to a jury on an agreed statement of facts (Rec., 2), from which it appeared that the plaintiff claimed to deduct from its return as "a reasonable allowance for depreciation of property" within the meaning of the corporation tax act the full value in place of the ore mined during the year in which the tax in question accrued, which value it estimated as the difference between the gross receipts from the

sale of the ore and the expenses incurred in extracting, mining, and marketing the same. (Rec., 3.)

The district court directed a verdict for defendant on this portion of the plaintiff's claim (Rec., 4), and a writ of error being sued out the Circuit Court of Appeals for the Eighth Circuit certified the three following questions:

> 1. Does section 38 of the act of Congress entitled "An act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August 5, 1909 (36 Stat., p. 11), apply to mining corporations?
>
> 2. Are the proceeds of ores mined by a corporation from its own premises income within the meaning of the aforementioned act of Congress?
>
> 3. If the proceeds from ore sales are to be treated as income, is such a corporation entitled to deduct the value of such ore in place and before it is mined as depreciation within the meaning of section 38 of said act of Congress?

ARGUMENT

I

The corporation tax act applies to mining corporations.

This is determined by the language of the act (36 Stat., II, 112, c. 6, sec. 38), which includes "every corporation" and does not by its exemptions exclude mining corporations, and by the decisions of this court in *Gay* v. *Baltic Mining Company* and *Mitchell*

v. *Clark Iron Co.* (220 U. S., 107.) In the former case the record shows (Rec., 2) that the Baltic Mining Company by the terms of its articles of incorporation was organized "for the purpose of engaging in and carrying on the business of mining, refining, and smelting copper and copper ores and minerals containing copper and copper ores, and manufacturing same."

The latter company is thus described by this court (220 U. S., 170):

> The Clark Iron Company was organized under the laws of Minnesota, owns and leases ore lands for the purpose of carrying on mining operations, and *receives a royalty depending upon the quantity of ore mined.*

Both companies were held to be within the act.

II

The proceeds of ore mined by a corporation on its own premises are income within the meaning of the act.

This is likewise determined by the two cases before referred to, and especially by the case of the Baltic Mining Company. This court could not have held that corporation within the act without deciding that it had an income. On page 7 of the original brief filed for the appellant in that case, counsel makes the following argument:

> A tax on the profits of a mining company may, indeed, be said peculiarly to be a direct tax. It is a tax on a portion of the land itself. Moreover, it is more than a mere income tax; it is a tax on the very corpus of the property;

> for the court will take notice that the sales of ore represent in no sense *income*, but rather a portion sold of the land itself. Mining companies present a case of "wasting investment." The smelting that may be engaged in is merely a part of the preparation of its own ore for the market. (Brief in Supreme Court, *Joseph E. Gay, Appellant*, v. *The Baltic Mining Company et al.*, p. 7.)

The point therefore was clearly presented to this court and must have been overruled.

This result also follows from the nature of capital and income in relation to mining companies as explained in the authorities, and as derived from the language of the corporation tax act itself. Prof. Fisher in his treatise on the nature of capital and income, page 52, gives the following definitions:

> A *stock of wealth* existing at an *instant* of time is called *capital*. A *flow of services* through a *period* of time is called income.

And the Supreme Court of Georgia, in *Waring* v. *Mayor, etc., of Savannah* (60 Ga., 93, 100), said:

> The fact is, property is a tree; income is the fruit.

These definitions are in accord with the usage of business men, and the terms "net income from all sources," and "gross amount of the income from all sources," in section 38 of the act of August 5, 1909, must have been used in this same sense. When, therefore, capital is by labor changed from a fund into a flow, it necessarily changes its character from

capital to income. In the case of a mine, the mineral as it lies in the ground is capital, but when it is extracted, converted into ore and sold, the result is a flow; the tree has borne fruit, and income has accrued.

The argument that, since this flow necessarily results in depletion or exhaustion of capital, therefore the flow is a flow of capital and not of income, is entirely fallacious, according to the above definitions, the understanding of business men, and the practical necessities of a tax based on income. The law takes things as it finds them; it taxes property under the character which the owner has impressed on it, and where that owner voluntarily changes his fund of capital into a flow of income the law accepts the designation and taxes him accordingly. This was clearly expressed by the chancellor of the exchequer of Great Britain in the parliamentary report on the income tax in 1861 (29 Law Quart. Rev., 170), when, explaining the taxation of terminable annuities as income, he said: "It is capital converted by the deliberate act of its owner into income for the very purpose of being expended annually." So Farwell, L. J., said in *Stevens v. Hudson's Bay Co.* (101 Law Times, 96, 97):

> Income is not the less income for the purposes of income tax because it is produced by embarking capital in a wasting subject matter—e. g., in buying and working mines; * * *.

Mr. Morawetz states the principle more fully in his work on Private Corporations (2d ed.), section

442, where, after stating that corporations whose capital is intended to provide a permanent means of carrying on business must first charge off depletion in plant or stock, he says:

> The rule stated in the preceding section has no application to a corporation whose sole purpose is to invest its capital in a specific piece of property like a mine, and afterwards to consume the property or extract its value at a profit. The capital of a mining company is not designed to be used like that of a banking or manufacturing company in carrying on business permanently. The working of a mine necessarily causes it to become exhausted and to depreciate in value, and this depreciation can not be repaired. There would be no object in accumulating the money obtained by the company through working the mine, so as to keep up the original amount of capital. It is implied from the character of the speculation of a mining company, that the income derived from working the mine shall be distributed among the shareholders as dividends, after deducting the expenses, and making reasonable provision for contingencies.

All the judicial authority is to the same effect.

(*a*) An ordinary life tenant may not open new mines, but when opened, he may work them, even to exhaustion, and where an equitable life tenancy is created by will, and the trustees are authorized to lease mines, the rentals from such leases are income and go to the life tenant, even though the lease runs until exhaustion of the minerals. (*Daly* v. *Beckett*,

24 Beav., 114; *Clegg* v. *Rowland*, L. R., 3 Eq., 368; *Eley's Appeal*, 103 Pa. St., 300; *McClintock* v. *Dana*, 106 ib., 386; *Shoemaker's Appeal* (ib., 392); *Raynolds* v. *Hanna*, 55 Fed., 783, 801, per Jackson, J.) In *Eley's Appeal*, supra, the court said (p. 306):

> The word "income" means the gain which accrues from property, labor, or business. In its ordinary and popular meaning, it is strictly applicable to the periodical payments, in the nature of rent, which are usually made under coal and other mineral leases, and we have no doubt it was used in that sense by the testator.

(*b*) A lease by the State of the minerals under its public lands would not be a sale of such lands, though the effect of the demise might be the exhaustion of the minerals. (*State* v. *Evans*, 99 Minn., 220.)

(*c*) The payment of dividends by a mining company out of the proceeds of ore sold, deducting merely working expenses, is not a payment out of capital. (*Lee* v. *Neuchatel Asphalte Company*, 41 Ch. Div., 1; *Excelsior Water & Mining Co.* v. *Pierce*, 90 Cal., 131, 140.) In the latter case a statute of the State forbade the payment of dividends out of capital. In *Lee* v. *Neuchatel Asphalte Co.*, supra, Lopes, L. J., said (p. 27):

> But it is said that where the capital is in its nature of a wasting character, depreciated by effluxion of time or exhaustion of materials, as in the case of mines or leaseholds, then a sum must be laid aside to meet the gradual depreciation, and that until such sum is laid aside there is nothing in the nature of

> profits divisible amongst the shareholders. * * *
>
> The capital in an undertaking like this is in its inherent nature wasting. The scheme of this undertaking is that there should be a gradual exhaustion of materials; the wasting is the business of the company, and without such gradual exhaustion there would be no revenue.

(*d*) The fact that the operation of a mine may decrease its valuation by exhaustion does not prevent the profits of the business of a mining corporation not devoted to dividends from being properly denominated surplus. It was accordingly held that surplus earnings of a New York corporation, or property purchased with and representing such surplus, was not taxable as "capital stock employed within this State," under the corporation-tax act of 1880, as amended. (*People* v. *Roberts*, 156 N. Y., 585.)

(*e*) It has been expressly held by the Supreme Court of Pennsylvania that oil companies and mining companies have income within the meaning of an income-tax act. (*Commonwealth* v. *The Ocean Oil Co.*, 59 Pa. St., 61; *Commonwealth* v. *Penn. Gas Coal Co.*, 62 Pa. St., 241.) In the former case the court said (p. 64):

> The present company pays dividends which are of course its net earnings or income, and it is the net income, whether declared or not, the State intended to tax.

The principle for which the mining companies contend is not applicable to them alone, and if applied generally, as it must be if applied at all, would seriously hamper the working of an income tax. A pension or a terminable annuity produces an income at the expense of capital, but who would think of calling such produce any the less income? An individual exhausts by his labors the capital represented by his education and abilities, yet no income tax could possibly treat his profits or wages as wholly or partially not income, but depletion of capital. It was well said by Lord Blackburn in *Coltness Iron Company* v. *Black*, 6 App. Cas., 315, 336:

> It has also been sometimes argued that it is very unjust to tax at the same rate a terminable interest, such as that in a mine, which must at some time be worked out, and a fee simple interest, which will endure so long as this world continues in its present state. I will not inquire whether this is just or not. There is much force in the argument on the other side, that if the interest is terminable, so is the tax, and will cease when the interest ceases. But whether just or not, there can be no doubt that the same annual charge is imposed upon a terminable annuity and on one in perpetuity; and, what seems harder, that the same annual charge is imposed upon a professional income, earned by hard labour, often extending over many years before any return is got, and, when earned, precarious, as depending on the health of the earner (p. 336).

Furthermore, if receipts from a wasting property as mines are not income, but divisions of capital, conversely the increment in appreciating property should be considered income. If a company, instead of investing its money in a mine, should put it into timber-bearing property where no income was derived for some years, though the value of the property as a potential income producer was increasing, this future income must be discounted and a tax paid on it, as though it really existed. Where the same sum of money is invested (a) in an annuity for six years, (b) in a perpetual annuity to begin 10 years hence, both annuitants would have the same income each year, according to the theory advocated by the mining companies, though in reality they would have nothing of the sort.

III.

A mining company is not entitled to deduct the value in place of ore mined during the year as depreciation within the meaning of the corporation tax act.

The act provides that net income shall be ascertained by deducting from the gross income from all sources (1) all ordinary expenses, (2) all losses not covered by insurance, "*including a reasonable allowance for depreciation of property*, if any," (3) interest on debts, (4) taxes. The fifth deduction is not important here. The third paragraph of section 38 prescribes the form of a return to the collector, and the fifth item therein is stated in part as "the total amount of all losses actually sustained during the

year and not compensated by insurance or otherwise, stating separately *any amount allowed for depreciation of property.*"

In the absence of any showing to the contrary, the word "depreciation" here must be given its ordinary meaning in business usage, and also it must be taken as similar in meaning to a "loss." So considered, depletion of capital can not be called "depreciation," nor would any business man think of so calling it. When capital is converted into income, as when a loaf of bread is eaten, it can not be said that the capital has "depreciated"; it has merely been converted into another form. "Depreciation" takes place when the capital, retaining its form, decreases in value owing to wear and tear, change of fashion or methods of manufacture, or the like. When a fund of capital in a mine consisting of the ore in place is converted into a flow of income resulting in money to the owners, the ore has not depreciated; it has suffered a change. Gold is mainly valuable because it does not depreciate. The buildings, machinery, shafts, etc., do depreciate. They retain their form and use, but their value diminishes at different ratios with different causes.

If a man have a stock of goods and he sell some and the balance become worthless through a change of fashion, it would be absurd to call the two processes by the same name, nor would any business man carry the results to the same account. In fact in the Nipissing Mines Company case, in which a writ of certiorari from this court is asked, the company in its

second return abandoned the theory of depreciation and replaced it with the items "return of capital," "distribution of capital nontaxable."

Under the English income-tax acts a like attempt has been made by mining companies to deduct as depreciation the depletion of capital. This attempt succeeded in *Knowles* v. *McAdam* L. R. (3 Ex. Div., 23), where the Court of Exchequer held that a mining company was entitled to a deduction for exhaustion of capital, but this case was expressly overruled in *Coltness Iron Company* v. *Black* (6 App. Cas., 315). In this latter case a claim for deduction was made for the estimated cost of sinking new pits, but the House of Lords unanimously refused to allow it. It may be claimed that this case is not applicable here as it arose under Schedule A of the act which, it may be claimed, taxes property and not income; but as pointed out by Mr. Strachan in his article on "Capital and income under the income-tax acts" (29 Law Quar. Rev., 163, 169), the tax levied under each and every schedule of the act is an income, not a property tax, and he quotes the language of Lord MacNaghten in *The London County Council* v. *The Attorney General* (1901, A. C., 26, 35), where he says:

> Income tax, if I may be pardoned for saying so, is a tax on income. It is not meant to be a tax on anything else. It is one tax, not a collection of taxes essentially distinct. There is no difference in kind between the duties of income tax assessed under Schedule D and those assessed under Schedule A or any of the other schedules of charge.

Moreover, in *Alianza Company* v. *Bell* (1904, 2 K. B., 666; 1905, 1 K. B., 184; 1906, A. C., 18) the company, since its mine lay in a foreign country, was assessable under Schedule D, which explicitly assesses profits and gains; and all the courts held that the principles laid down in *Coltness Iron Co.* v. *Black* were applicable to their full extent.

In this country the same rule was adopted by the officials charged with administering the Civil War income tax, as appears from the decision of the Commissioner of Internal Revenue of May, 1863, reported in Boutwell on The Direct and Excise Tax System of the United States, pages 273, 274. The Commissioner of Internal Revenue ruled that "No deduction can be made because of the diminished value, actual or supposed, of the coal vein or bed by the process of mining"; and apparently this ruling was never questioned.

IV.

Depreciation to be allowed as a deduction under the corporation tax act must be actually paid, and not merely estimated.

It is admitted that the mining company in this case never actually retained any sum and applied it to depreciation. In fact, it distributed all its net earnings in dividends, and it now claims, in effect, that a part of them *should* have been retained and placed in a depreciation fund, and that this ideal depreciation should be allowed as a deduction. But the corporation tax act places depreciation in the

same class as "losses *actually sustained* within the year," and in giving the form of the return requires a separate statement of "amounts *allowed* for depreciation." It is clear that the depreciation referred to is an *actual allowance* made for that purpose during the year. A taxpayer is not favored by exemption from the maxim that he can not have his cake and eat it too. He can not enjoy the benefits which come from income and then repudiate the burden of taxation by saying that he *did not have* such income, because he *should not have had it*, but *should* have put part aside to cover depreciation. The matter is well expressed by Prof. Fisher in the treatise referred to above (pp. 238, 239, 255):

> * * * A pension is an income the capital value of which is continually diminishing. Yet even popular usage seldom or never deducts this depreciation from the pension to obtain the "true" income; and the reason we instinctively include (as we ought) the whole of such a pension in income is that the depreciation is not actually offset. In ordinary business, on the other hand, we are accustomed to deduct depreciation, because this is usually offset by actual payments into a depreciation fund. Even in this case the depreciation is not *itself* an expense; but there is a concomitant expense approximately equal to it in the form of payments into the depreciation fund. It thus makes all the difference in the world whether the depreciation fund is actually maintained or merely reckoned. If a depreciation fund is actually

> maintained, the expense of maintaining it serves to reduce realized income so as to make it coincide with earned income. In such a case, therefore, the ideal earned income becomes realized in actual fact. * * *
>
> * * * * *
>
> * * * We have learned, then, to distinguish between standard and realized income. The one is ideal, the other actual. The one is that income which, if it were received, would leave the level of capital value unchanged; the other is that income which is actually received and detached from capital, no matter whether that capital, as a result, is increased or decreased. In short, the one is earned, the other realized. * * *

It is therefore respectfully submitted that the first question certified by the Circuit Court of Appeals for the Eighth Circuit should be answered in the affirmative, the second question in the affirmative, and the third question in the negative.

SAMUEL J. GRAHAM,
Assistant Attorney General.

OCTOBER, 1913.